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PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Telecommunications Division
Market Structure Branch

RESOLUTION T-16656
June 27, 2002

R E S O L U T I O N

RESOLUTION T-16656. VERIZON CALIFIORNIA, INC. (U-1002-C). ORDER ACCEPTING WITH MODIFICATION ADVICE LETTER FILING MADE IN COMPLIANCE WITH DECISION 98-10-026.

BY ADVICE LETTER NO. 9944 FILED ON DECMBER 12, 2001.

SUMMARY

This resolution accepts, subject to correction, adjustment, or future Commission order, Verizon California Inc.'s (Verizon) 2000 Rate of Return (ROR) adjusted for directory revenue and expenses from its supplemental 2000 sharable earnings advice letter (AL) 9944.

Since sharing has been suspended in Decision (D.) 98-10-026, effective 1999, there is no immediate impact on sharable earnings as a result of this filing.

BACKGROUND

New Regulatory Framework (NRF)

At the conclusion of the third triennial NRF review, the Commission issued D. 98-10-026, which suspended sharing effective January 1, 1999, continued the requirement for the reporting of rates of return, phased out existing Z factor adjustments and eliminated new Z factor adjustments, and included a provision for the consideration of only a very limited set of exogenous costs, and the continued rate caps and floors.

Pursuant to D. 98-10-026, on April 2nd 2001, Verizon filed its 2000 Annual Rate of Return advice letter (AL 9728) for the purpose of reporting its rates of return and the market-based, benchmark, ceiling, and floor rates of return last found reasonable. In AL 9728 Verizon reported that its intrastate rate of return was 10.97%. In Resolution T-16572 on October 25th 2001, the Commission approved Verizon's filing subject to any corrections or adjustments that may arise from the NRF Review proceeding (R.01-09-001/I.01-09-002).

On December 12th 2001, Verizon submitted AL 9944 which amended AL 9728 for a number of separations-related issues, certain accounting issues, and to reflect Yellow Pages advertising revenues in a manner consistent with prior earnings statements. Verizon reported that 11.39% was its intrastate ROR for 2000, revised to for the accounting changes. Verizon also reported an estimated ROR of 13.96%, which reflects accounting changes and the inclusion of Yellow Page advertising revenue. Verizon states that the Yellow Page advertising revenue was included for information purposes only. Other references reported in Verizon's filing included the following rates of return:

Market-Based	10.50%
Ceiling	15.50%
Floor	7.75%

NOTICE/PROTESTS

Verizon states that the advice letter was mailed to interested parties on December 12, 2001. The Advise letter appeared on the Commission calendar January 4th 2002.

ORA sent in protest to AL 9944 on January 23, 2002. ORA protested, as they believe that Verizon is required to include directory revenues and expenses in its intrastate ROR.

ORA disputes the qualifying footnote that the estimated ROR including directory-listing revenue is for information purposes only. ORA states that directory revenue and expenses have always been included above the line for ratemaking purposes. ORA contends that according to CPUC code, and NRF decisions directory revenue is to be used in calculating the utilities intrastate results of operations and revenue requirements when setting rates for Category I, and Category II services.

ORA makes four recommendations regarding the advice letter.

1. ORA suggests that the approving resolution should affirm that Verizon is required to include directory revenues and expenses in its ROR, and strike the qualifying footnote.
2. ORA suggests that the Commission require Verizon to restate all monitoring reports that omitted directory revenue and expenses in their results of operations beginning with the year 2000.
3. ORA suggests that the Commission order Verizon to prospectively include an imputation adjustment to include directory revenue and expenses in all monitoring reports filed with the commission. The imputed adjustment will reflect the amount of revenue Verizon would have received had it not changed its contract with its publishing affiliate VIS.
4. ORA recommends that the resolution should state that the earnings statement remains subject to any adjustments found necessary as a result of future audits.

Verizon mailed a response on January 30, 2002, which disputed ORA's recommendations. Verizon claims that ORA's protest is "inconsistent with Commission precedent, seeks to prejudge the outcome of the 4th Triennial review of the New Regulatory Framework (NRF review), and seeks actions which are wasteful and unnecessary"

Verizon also argues that ORA's recommendation violates both Commission reporting requirements as set forth in D.91-07-056, and general accepted accounting principles.

Verizon claims that D.91-07-056 states that earnings are to reflect each year's operation as booked. Verizon also points out that the FCC has stated that yellow page revenues "may not be recorded on the carriers books"[1]. The FCC does not prohibit states from imputing revenues related to yellow page revenue for the purpose of state ratemaking, however, "states must exercise this authority without the use of part 32 accounts.

Verizon further contends that ORA's requested finding of fact would prejudge the outcome of the upcoming NRF review. Verizon points out that this issue is to be determined in Phase 3 of the NRF review.

Finally Verizon states that ORA's request for restatement of other monitoring reports is wasteful, and unnecessary. Verizon claims that by its count ORA's request could affect upwards of 30 quarterly, and monthly monitoring reports, some of which are submitted to other agencies, or are governed by FCC accounting policies. Verizon states that changing these reports would violate precedent and create confusion and complication, while presenting no new information.

DISCUSSION

Even though sharing has been suspended, the information reflected in the annual earnings filings and other monitoring reports is a critical element of the NRF and is valuable to the Commission and other interested parties. The data contained in the affected reports may be used to support changes or reforms in the regulatory framework, or in evaluating a carrier's results of operations. Consequently, it is vitally important that Verizon report appropriate above-the-line operations for ratemaking purposes.

As ORA pointed out, the CPUC code is clear on the above-the-line treatment of directory revenues and expenses:

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[1] Local Exchange Carriers' Permanent Cost Allocation Manuals for the separation of regulated and unregulated costs, AAD Nos 92-22 through 92-35, 9 FCC Rcd 4457(rel. August 29, 1994), para. 7

> Public Utilities Code 728.2 (b)(1)
>
> The Commission's jurisdiction to regulate commercial advertising in alphabetical and classified directories of telephone corporations under this subdivision shall be limited to the rates and charges for commercial directory advertising, except that **the commission shall investigate and consider revenues and expenses of telephone corporations related to that advertising for purposes of establishing rates for other services offered by telephone corporations.**[2]

ORA are also correct that when the Commission adopted the NRF, directory revenues were included above the line. Since then no decision has relieved Verizon of this obligation.

Verizon's contention that including yellow page revenue in the intrastate rate of return would violate Commission and FCC precedent is incorrect. The FCC's own policy affords that "states may have the authority to impute revenues related to affiliate publishing of yellow pages directories for state ratemaking purposes."[3] Further, D. 91-07-056 states that the earnings calculations start with the Part 32 accounts less Parts 36 (separations), and 64 (below-the-line cost allocations) and allows "any modifications to those parts instituted by this commission." Traditionally, directory revenue has been included as one of these modifications. TD staff believes that an imputed amount for directory revenue should be included for purposes of calculating Verizon's intrastate rate of return until such a time as the Commission has relieved Verizon of this requirement.

Verizon's contention that finding directory revenues a required part of the intrastate ROR predetermines the outcome of the NRF review is incorrect. As directory revenue has always been a part of intrastate ROR, the Commission would be predetermining the outcome only if we did not include it.

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[2] Emphasis added

[3] Local Exchange Carriers' Permanent Cost Allocation Manuals for the Separation of Regulated and Unregulated Costs, AAD Nos 92-22 through 92-35, 9 FCC Rcd 4457 (rel. Aug. 29, 1994), para. 7

We also agreed with ORA that it is inappropriate for a footnote to be included in the Intrastate Earnings Report that states the reporting of directory revenues and expenses is “for information purposes only”.

We are not persuaded by Verizon’s contention that restatement of other monitoring reports is unnecessary. To be effective monitoring reports must be complete. Therefore, Verizon should correct each of its monitoring reports, which include California intrastate earnings as reported in the Intrastate Earnings Report to reflect imputed earnings from directory operations. We direct Verizon to follow this reporting process going forward until Verizon is relieved of this obligation by a Commission order.

We believe Verizon AL# 9944 should be accepted subject to correction or adjustment by future Commission order.

COMMENTS ON DRAFT RESOLUTION

Verizon filed comments on the Draft Resolution on April 30, 2002. In their comments Verizon argued three things. First, Verizon argued that not accepting Verizon’s booked revenues violates Commission precedent, and creates inaccurate monitoring reports. Verizon supports this by reiterating that they filed their earnings in accordance with D.91-07-056, and that FCC parts 32, 36, and 64 are the basis of the earnings calculation. Second, Verizon argues that the resolution unnecessarily opines on a disputed issue currently set for hearing in the NRF proceeding.

Finally, Verizon contended that reinstatement of all other monitoring reports is legally flawed and impossible to implement. Verizon stated that by their count upwards of 30 monthly quarterly and annual reports over the past year would be affected, and that some of these reports are filed with other agencies (e.g. the SEC 10K report, and the FCC Form M report). Verizon claimed that as some of these reports had been audited and found to reflect Verizon California's consolidated financial statements, they could not be corrected by Commission order.

DISCUSSION OF COMMENTS ON DRAFT RESOLUTION

Verizon's first two comments are reiterations of their arguments in their January 30, 2002 response to ORA's protest. TD's analysis of these arguments has not changed since the writing of the draft resolution.

Verizon's third comment, though also for the most part a reiteration of their earlier argument, does bring to light a potential problems associated with restating those monitoring reports that were affected by the change in Yellow Pages advertising revenues. Verizon claims that more than 30 monthly, quarterly and annual reports over the past year (as well as that many reports per year on a prospective basis) would be affected. Verizon claims that some of the reports cannot be corrected by Commission order, and cites as examples Securities and Exchange Commission reports, Federal Communications Commission reports, and reports that have been audited and found to reflect Verizon California's consolidated financial statements. We are surprised that so many monitoring reports have been affected by the change in the Yellow Pages directory arrangement. It would have been helpful if Verizon had identified the specific reports that it refers to.

It is unfortunate that Verizon made a decision to change its arrangement for Yellow Pages advertising without consulting the Commission before doing so. The arrangement that Verizon entered into reduces revenues that are generated from a source that has traditionally been treated above-the-line for intrastate ratemaking purposes and is available to support the costs of providing telephone service. We believe that it would have been reasonable for Verizon to expect that the Commission would have interested in learning about the proposal to alter the arrangement for Yellow Pages advertising revenues prior to effecting the change so that the Commission could review and evaluate the proposed change. Verizon was aware that some of the NRF Monitoring reports that have been adopted by the Commission incorporated the Yellow Pages advertising revenues, and that changes to the Yellow Pages arrangement would have an effect on these reports.

Verizon’s point that some of the monitoring reports, such as SEC and FCC reports cannot be modified by Commission order is well taken. We are sensitive to the burden imposed by requiring Verizon to restate all monitoring reports that have been affected by the Yellow Pages directory arrangement change. However, as ORA correctly points out, Yellow Pages revenues have been included for ratemaking purposes. These revenues are also used for calculating California regulated intrastate rate of return, and the Commission monitors carrier intrastate earnings and intrastate rate for return for unreasonable earnings and rate of return.

We believe that we can minimize the burden on Verizon while retaining necessary information for the Commission to monitor Verizon’s intrastate regulated earnings and rate of return by requiring Verizon to provide two versions of the two NRF Monitoring Reports entitled “Recorded and Adjusted Separated Results of Operations” (Monitoring Report Code GD-04-00 and Monitoring Report Code GD-04-01), consistent with the NRF Monitoring report filing schedule. Verizon should also provide two versions of the Intrastate Earnings Report. One version of each report shall reflect Verizon’s actual Yellow Pages directory arrangement, and the second version of each report shall be presented on a basis that existed under the prior Yellow Pages directory agreement. Each version of each report should be clearly identified to describe the basis of presentation. Both versions of the Intrastate Earnings Report shall be included with Verizon’s annual earnings filing. For the years 2000 and 2001, for each of the reports identified above, Verizon shall provide the two versions of the year-end report. Beginning with the year 2002 and forward until directed otherwise by the Commission, Verizon shall provide monthly and/or quarterly submissions of both versions of each of the of the three reports.

We are interested in which of the NRF Monitoring Reports have been affected by the change in the arrangement for Yellow Pages advertising revenues. Within 30-days of the effective date of this Resolution, Verizon shall file with the Telecommunications Division, and provide a copy to ORA, a list of each monitoring report, by name and Monitoring Report code, that the company believes are affected by the change in Yellow Pages directory arrangement, and identify the entities that originated the reports (e.g. SEC, FCC, CPUC, Company internal, etc.). Verizon shall continue reporting on this basis until directed by the Commission to do otherwise.

FINDINGS

1. Advice Letter 9944 was filed in a timely manner.
2. Advice Letter 9944 included an intrastate ROR, and an intrastate ROR adjusted for an estimate of Yellow Pages advertising revenue.
3. The reported ROR estimated Yellow Pages advertising revenue had Verizon not changed its contract with its publishing affiliate VIS.
4. Confidential cost support was included in the filing.
5. A timely protest to this advice letter was filed by ORA.
6. Verizon filed a reply on January 30, 2002.
7. The Commission has always required Verizon to include directory revenues and expenses in its intrastate ROR.
8. Continuing to include directory revenues and expenses as an above the line contribution to Verizon's Results of Operations does not prejudge the outcome of NRF.
9. Verizon should provide two versions of its intrastate earnings report and two versions of its separated results of operations reports. One version would show Yellow Pages directory revenues using the existing arrangement and the other version would show the Yellow Pages directory revenues using the previous arrangement.

10. Verizon's reported 2000 intrastate ROR is 13.96% and includes an imputed adjustment for directory revenue and expenses.
11. The qualification "for information purposes only" in note #3 in Verizon advice letter 9944 should be stricken.
12. Restatement of monitoring reports starting January 1, 2000, and prospective changes to future reports is appropriate.
13. The reference RORs are as follows:

   - Market-Based – 10.5%
   - Ceiling – 15.5%
   - Floor – 7.75%

14. Sharing is currently suspended. Had there been sharing the calculated amount on the revised ROR would have been $0.

THEREFORE IT IS ORDERED THAT:

1. Verizon's revised 13.96% ROR is accepted subject to correction or adjustment pending future Commission order, and the phrase "for information purposes only" in note 3 of AL 9944 shall be stricken.
2. Within 30-days of the effective date of this order Verizon shall file with the Telecommunications Division and ORA, a list by name and Monitoring report code, of each monitoring reports that the company believes are impacted by the Yellow Pages advertising revenues and to identify the entities that originated the reports (e.g. SEC, FCC, CPUC, etc.).
3. Within 30-days of the effective date of this Resolution, beginning with the period January 1, 2000, Verizon shall provide as NRF Monitoring Reports, two versions of the two NRF Monitoring Reports entitled Recorded and Adjusted Separated Results of Operations (Monitoring Report Code GD-04-00 and Monitoring Report Code GD-04-01), and to provide two versions of the Intrastate Earnings Report. One version

of each report shall reflect Verizon's actual Yellow Pages directory arrangement, and the second version of each report shall be presented on a basis that existed under the prior Yellow Pages directory agreement. Each version of each report shall be clearly identified to describe the basis of presentation. Both versions of the Intrastate Earnings Report shall be included with Verizon's annual earnings filing. For the years 2000 and 2001, for each of the reports, Verizon shall provide the two versions of the year-end report. Beginning with the year 2002 and forward, Verizon shall provide monthly and/or quarterly submissions of both versions of each of the three reports.

4. Verizon will continue to provide the two copies of each of the reports described above until such time that the Commission directs otherwise.
5. Advice Letter 9944 is approved, subject to correction or adjustment as determined necessary by the Commission, and subject to the conditions contained herein.

This Resolution is effective today.

I hereby certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on. June 27, 2002. The following Commissioners approved it:

WESLEY M. FRANKLIN
Executive Director